

**DEPARTMENT OF MOTOR VEHICLES
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 1999**

***AUDITOR OF
PUBLIC
ACCOUNTS***



COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Motor Vehicles Operating Fund Cash Flow

Cash balances in Motor Vehicles' operating fund have decreased to critically low levels from \$3.7 million in 1997 to approximately \$400,000 in 1999. Management had originally projected a cash deficit of \$6 million in the operating fund at June 30, 2000. However, with proposed cost cutting measures for the remainder of fiscal year 2000, that estimate has changed to a \$100,000 positive balance. This presents a cash flow problem for an agency with semi-monthly payrolls of \$3.7 million and regular vendor bills to pay. Motor Vehicles must often wait for the collection of fees in order to pay bills.

Motor Vehicles cannot meet its operational needs because the rate of growth in expenses has outpaced the growth in revenues. Over the past five years, operating revenues have increased at approximately 2 percent per year whereas expenses have increased at a 4.5 percent rate. Personnel costs comprise the majority of the expense increases. Employee cost of living adjustments, upgrades of several existing salaried positions, an incentive bonus program, and an increase in the number of wage employees over the past two years have contributed to the increased personnel costs.

Motor Vehicles continues to experience problems in meeting payments for current obligations. The Department cannot comply with the State's prompt payment performance standard for timely payment of invoices. Unpaid obligations at June 30, 1999 increased to \$6.7 million dollars, almost twice the amount from the previous year. With the increase in unpaid obligations, Motor Vehicles effectively had a fund deficit of \$1.8 million at June 30, 1999.

Motor Vehicles' strategy to address its cash flow problem includes various cost-cutting measures and revenue enhancement projects. Management faces hard decisions to balance the amount of cost reductions with the level of service quality and efficiency it provides to customers. These cost reductions could directly impact the number of personnel currently employed at Motor Vehicles. This strategy must provide sufficient resources to meet daily cash requirements and accumulate reserves necessary for unexpected disbursements. We have provided additional details and analyses in the "Agency Background" section of our report under Motor Vehicles Operating Fund.

Our audit of the Department of Motor Vehicles for the year ended June 30, 1999 found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no material weaknesses in internal controls; and
- no instances of noncompliance that are required to be reported.

AGENCY BACKGROUND

Motor Vehicles Operating Fund

Motor Vehicles collects special revenue funds designated for operating purposes. The primary revenue sources accruing to the Motor Vehicle's operating fund include rental vehicle tax, vehicle title fees, driver license fees, motor vehicle record fees, and reserved license fees. Motor Vehicles allocates these collections for use in its operating account in accordance with statutory requirements as set forth in the Code of Virginia. Major expenditures in the operating fund include personal services, postage, information technology, telecommunications, license plates, and equipment and plant rentals.

Low Cash Balances in the Operating Fund

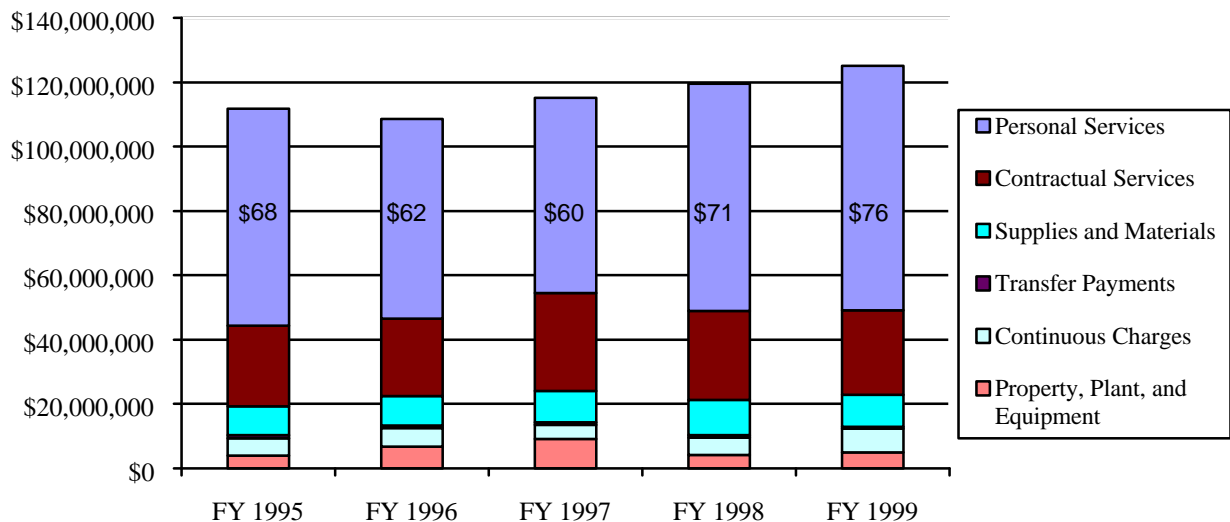
Cash balances in Motor Vehicles' operating fund have decreased to critically low levels from \$3.7 million in 1997 to approximately \$400,000 in 1999. Management had originally projected a cash deficit of \$6 million in the operating fund at June 30, 2000. However, with proposed cost-cutting measures for the remainder of fiscal year 2000, that estimate has changed to a \$100,000 positive balance. This situation has caused a cash flow problem for an agency with semi-monthly payrolls of \$3.7 million and regular vendor bills to pay. Motor Vehicles must often wait for the collection of fees in order to pay bills.

Factors Contributing to Decline in Operating Cash

Expenses Growth Outpacing Revenue Growth

Motor Vehicle operating revenues have increased at a lower percentage rate than operating expenses. Over the past five years, operating revenues have increased at approximately 2 percent per year whereas expenses have increased at a 4.5 percent rate. Transaction volumes and population trends influence a substantial amount of the operating revenues; however, these factors have not kept pace with the economic conditions that influence expenses. The chart below shows that Motor Vehicles has had no appreciable increase in non-personal service costs in the last five years. Personal service costs, however, have increased by 21.5 percent over the past two years alone.

FY 95 – FY 99 Expenditure by Object Code

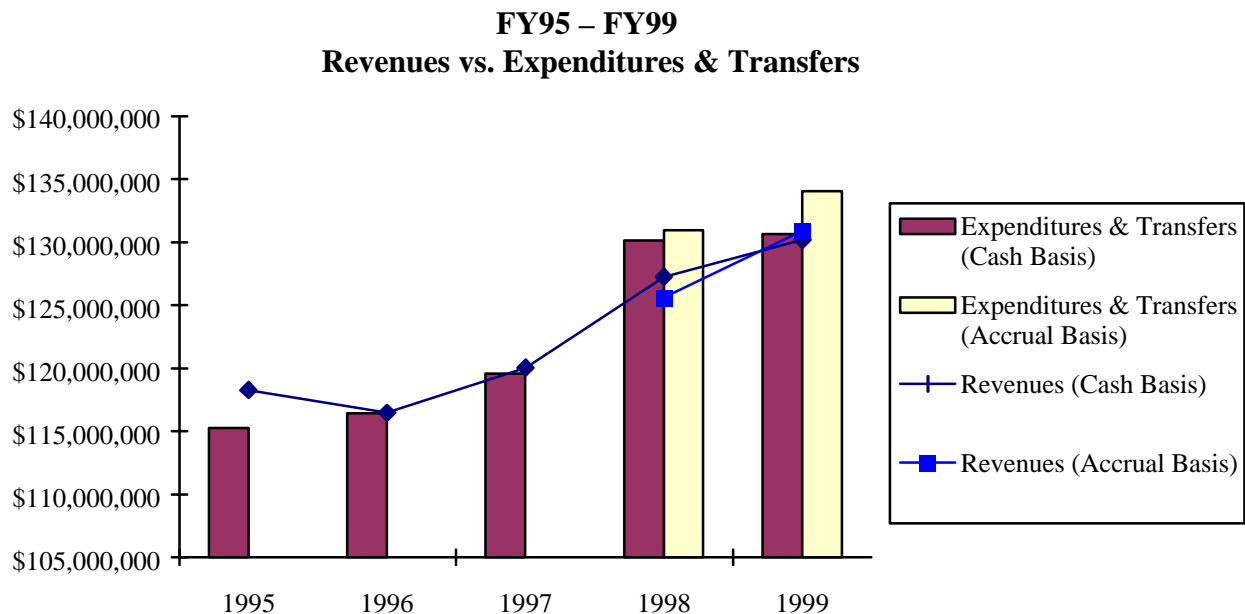


Employee cost of living increases averaging between 4.0 percent and 4.5 percent annually accounts for much of the increase in personal service costs. Management's decisions to attract and maintain skilled technical staff and to provide improved customer satisfaction have also contributed to the increase in these costs. To attain these goals, Motor Vehicles upgraded several existing salaried positions and offered a \$10,000 incentive bonus program to 123 individuals critical to the Year 2000 initiative. This bonus program alone cost Motor Vehicles \$1.2 million. The number of wage employees increased from 143 to 192 (34 percent) during the last two years. The Department placed many of these wage employees in various centers throughout the state to improve customer service.

Current Financial Status of Operating Fund

Operating Fund Deficit Continues to Increase

Operating expenses have reached the point where they equal or exceed revenues. The chart below compares operating revenues with operating expenses (including transfers) over the past 5 years on a cash basis. Fiscal years 1998 and 1999 also include this information on the accrual basis of accounting.



In years where expenses exceed revenues, Motor Vehicles used surpluses accumulated in prior years to cover the excess expenses. It is important to note that the accrual basis presents a more accurate measurement of Motor Vehicles' financial condition. This basis reflects uncollected revenues due to Motor Vehicles and all unpaid obligations at fiscal year end. Unpaid obligations at June 30, 1999 increased to \$6.7 million dollars, almost twice the amount from the previous year. With the increase in unpaid obligations, Motor Vehicles effectively had a fund deficit of \$1.8 million at June 30, 1999.

Motor Vehicles continues to have problems meeting its obligations (see "*Non-Compliance with Prompt Payment Requirements*" below). Unpaid vendor invoices as of March 2000 totaled approximately \$2.5 million of which \$1.2 million are past due. The Department does not have sufficient cash to pay these obligations nor to address contingencies and unexpected disbursements in the near future. Motor Vehicles cannot continue to accumulate these unpaid obligations considering its current cash position.

Non-Compliance with Prompt Payment Requirements

Motor Vehicles continues to experience problems in meeting payments for current obligations. With virtually no cash reserves, the Department often has to wait on the collection of fees to pay its bills. As a result, the Department cannot comply with the State's prompt payment performance standard. The standard requires that the agency pay 95 percent of vendor invoices within 30 days of initially incurring an obligation. Following are the Motor Vehicles' compliance rates for the past 6 quarters:

<u>Quarter Ended</u>	<u>Payments in Compliance</u>
12/31/98	89.9%
3/31/99	76.1%
6/30/99	71.5%
9/30/99	65.9%
12/31/99	70.6%
3/31/00	87.6%

Failure to pay invoices timely may cause the Commonwealth to lose vendor business. We noted one vendor has assessed a finance charge of \$8,900 for late payment. Motor Vehicles personnel meet daily to determine which invoices to pay based on projected collections for that day. Maintaining a sufficient cash balance would eliminate the need for this inefficient process.

Strategies to Address the Cash Shortfall

Motor Vehicles has identified certain strategies to address its critical cash flow situation. These strategies include an immediate reduction in discretionary expenses, identifying and implementing revenue enhancement strategies, and implementing program and operational savings. Motor Vehicles has begun to implement some of these strategies.

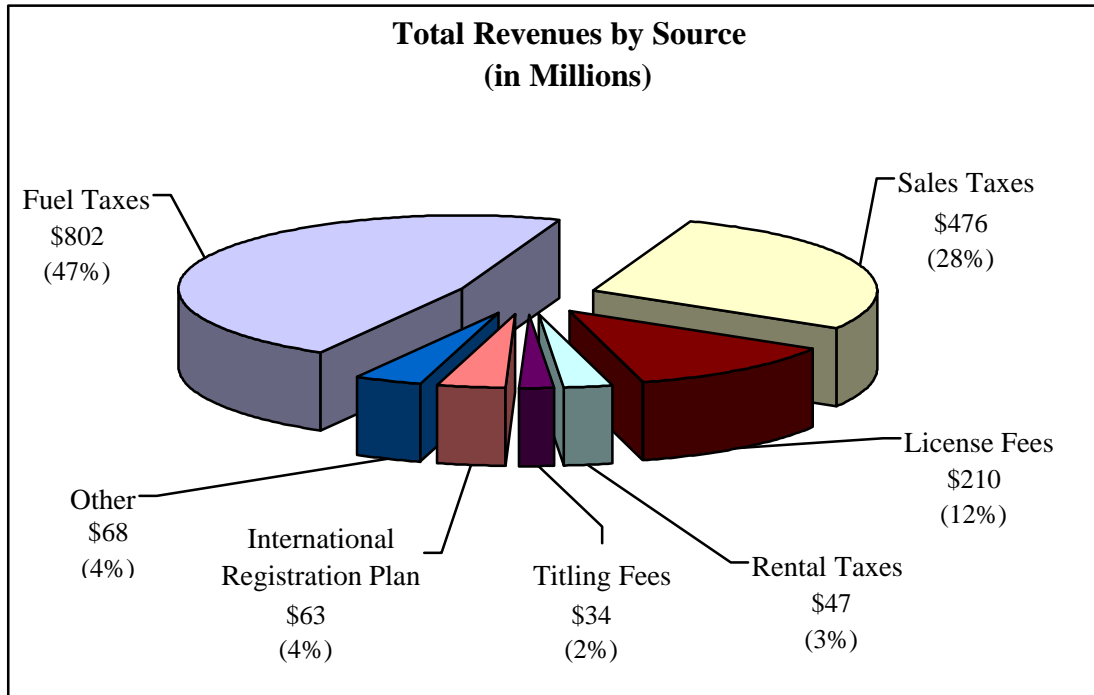
Management has reduced discretionary expenses in the current biennium to address the potential cash deficit. These discretionary expenses include travel, wage, overtime and contractual employees. Management estimates savings of \$600,000 by these cost cutting measures. Furthermore, management has delayed all capital and renovation projects totaling \$3.7 million in order to increase available cash.

Motor Vehicles plans to generate increased revenues by providing new or additional services for a fee. These plans include producing a variety of special license plates and providing certain information to commercial entities and schools for a fee. Motor Vehicles must also consider its existing fee base and the ability of that revenue stream to cover agency costs. Management may need to increase some agency fees or modify statutory allocations of existing fees.

A planned cost recovery program will assist in recouping labor, materials, and fixed costs for administrative services provided to other state agencies. Motor Vehicles provides administrative support and payroll functions for the Motor Vehicle Dealer Board as well as payroll functions for the Department of Taxation, the Science Museum, and the Virginia Museum of Fine Arts. At present, Motor Vehicles provides these services without recovering its costs from these agencies.

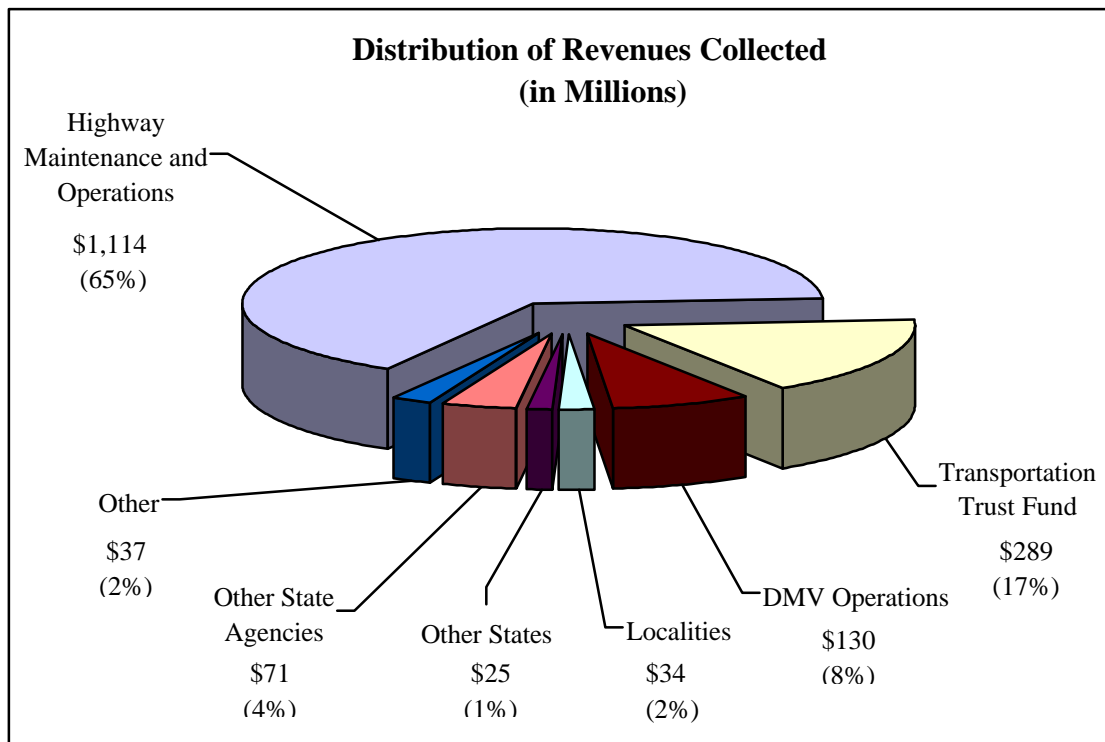
Revenue Collections

Motor Vehicles regulates the registration, licensing, and operation of motor vehicles and drivers within the Commonwealth. Motor Vehicles collected over \$1.7 billion in fiscal year 1999 from fees and taxes (see chart below).



Revenue Distributions

Motor Vehicles distributes revenue collections to the Commonwealth's Highway Maintenance and Operating and Transportation Trust Funds, other state agencies, localities, and other states (see chart on the following page). Over 83 percent of transfers for fiscal 1999 went to the Highway Maintenance and Operating and Transportation Trust Funds. The Virginia Department of Transportation uses those funds for maintenance and construction programs and also allocates funds in accordance with statutes to other transportation agencies. Motor Vehicles transfers revenues to other state agencies primarily to fund transportation and safety programs. Payments to localities represent an allocation of rental and mobile home tax collected in the locality. Motor Vehicles operations cost approximately \$130 million.



Personal Property Tax Relief Act

The 1998 General Assembly enacted the Personal Property Tax Relief Act which provides tax relief to citizens and their families on a portion of personal property taxes paid on the first \$20,000 of value for qualifying vehicles. The Act will phase out Virginia's personal property tax over five years. Qualifying vehicles for the program include privately owned cars, panel and pick-up trucks, and motorcycles.

For tax year 1998, localities billed taxpayers as usual and collected the personal property tax. The locality sent information denoting which vehicles qualified under the program, as well as the vehicles' value, tax assessment, and reimbursable amount of tax paid to Motor Vehicles. Motor Vehicles used the information to process checks for owners of all qualifying vehicles, reimbursing them 12.5 percent of the amount of tax paid for the 1998 tax year. For tax year 1999 and beyond, localities will offset tax billings based on a percentage rate set in the Act, and then receive payments from the state to cover the reduced tax collections. The following table shows the percentage of tax reduced each year:

Tax Year	Percentage
1998	12.5%
1999	27.5%
2000	47.5%
2001	70.0%
2002	100.0%

Motor Vehicles reconciles its internal records with localities' claims, and the Department of Accounts' reimbursements to ensure the proper reimbursements under the Act.

Motor Vehicles' Technological Initiatives

Motor Vehicles has implemented several technological initiatives to deliver improved service to its customers and to process transactions more efficiently. The following include some of the major initiatives.

- Motor Vehicles implemented the Purchasing Inventory and Payables System (PIPS) in response to previous audit findings concerning the controls and manual processes affecting these functions. PIPS is an Oracle Governmental Financials Software package that Motor Vehicles purchased in December 1997 at a cost of approximately \$300,000 with total implementation costs of approximately \$600,000. PIPS has five modules, implemented as follows:

Purchasing, General Ledger, and Payables – April 1999

Inventory – May 1999

Budget – July 1999

- KATS (Knowledge Automated Testing System) is a computerized driver's license testing system where applicants simply touch the computer screen to indicate their response to test questions and the system automatically stops testing as soon as the applicant reaches a pass or fail score.
- The creation of on-line information for access through the Internet provides a personal license plate inquiry and reservation program, addresses and directions to every Motor Vehicles office, and directions on how to process most Motor Vehicles transactions. Drivers can also update their insurance information on-line. Motor Vehicles now offers customers the option to renew vehicle registrations and driver's licenses through the Internet.
- Touch-tone telephones allow customers to renew and pay with a credit card vehicle registrations any time of day, seven days a week. Motor Vehicles still plans to expand the use of touch-tone telephones to allow customers to renew their driver's licenses.

March 31, 2000

The Honorable James S. Gilmore, III
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Richard J. Holland
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Motor Vehicles** for the year ended June 30, 1999. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objective, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Department's internal control, and test compliance with applicable laws and regulations. We also reviewed the Department's corrective actions of audit findings from prior year reports.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Expenditures
Revenues

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System.

We noted no matters involving internal control and its operation that we consider to be material weaknesses. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to financial operations may occur and not be detected promptly by employees in the normal course of performing their duties.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

The Department has taken adequate corrective action with respect to audit findings reported in the prior year.

This report is intended for the information of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on May 2, 2000.

AUDITOR OF PUBLIC ACCOUNTS

DEPARTMENT OF MOTOR VEHICLES
Richmond, Virginia

Richard D. Holcomb, Commissioner

Asbury W. Quillian, IV, Deputy Commissioner

John C. Christian, Jr., Controller

Larry E. Harrison, Budget Director